their expenses of production. But, where *competition is not free*, as in the example of the carpenter and the watchmaker, exchange value is not governed by cost of production, but, as Mr. Cairnes has clearly shown, by reciprocal demand. Under these conditions, if the value of one article relatively to another is out of proportion to the relative sacrifices incurred in their production, it may happen that the sacrifices in producing the one article will be more highly rewarded than the sacrifices in producing the other. If this be true, wages and profits, or the "expenses of production," are high, because of the influence of reciprocal demand.

J. LAURENCE LAUGHLIN.

SOME OBJECTIONS TO PROFIT-SHARING.

[The following pages are an extract from a Dissertation for which the author received a Bowdoin Prize in Harvard College in 1885. The author's consent to the present publication was asked, in view of the fact that his essay represents a side of the question as to Profit-sharing not commonly set before the public.]

The highest claims have been advanced by the advocates of industrial partnership for its possibilities in effecting a solution of the labor problem. The capitalist, it is said, may justly expect to see introduced into his relations with his work people stability and peace, a strong corporate spirit, and a feeling of solidarity of interests which shall secure real co-operation from them instead of perfunctory service, and put an end to that class feeling which bands workmen together as in a league against their employers. The workman, too, will receive, besides his increased share, indirect benefits of no little importance. The extra profit or bonus makes a valuable incentive to saving, and encourages a more intelligent spirit of toil and a better appreciation of the economic conditions surrounding business and industrial life. In short, through the beneficent workings of the system, the demands of labor will be met, and the disputes between labor and capital permanently ended. The influence of this change in the industrial conditions is expected to be so great as to

effect a moral regeneration among the laboring classes, to stir into activity all ranks of industrial life, and to quicken even the lowest of the world's workers with the fire of ambition from new opportunities for material advancement. A system which promises such momentous results, and which proposes so important a change in the relations between capital and labor, is worthy of the most careful examination.

In the first place, it is to be observed that the discussion by the advocates of profit-sharing is based, for the most part, upon the cases in which the scheme has been adopted in Europe and in this country. The methods of induction have been used almost altogether. But, in the study of any such important rearrangement of industrial relations as is contemplated by this system, an extremely full collection of data is necessary, in order to arrive at any conclusive result from induction. There are, at present, few such data at hand. All the instances ever collated, which are not more than one hundred in number, form a very small point in the great world of business. They can have but little weight in determining the value of industrial partnerships as a prevalent and permanent industrial arrangement. So many and various are the causes contributing to the success or failure of a year's business with any individual firm, that a very large number of cases must be taken from which to draw an average that would eliminate or offset against each other all accidental circumstances. Then, too, the actual application of the system of profit-sharing has been so limited that the cases, from their very novelty, have often been surrounded by a set of special circumstances. To allow the full import of industrial partnership to be seen, these special and accidental circumstances must be eliminated by averaging a great number of cases.

Let us, then, see what theoretical grounds can be found to base the discussion upon, since induction at present must prove inconclusive. And here it should be understood that industrial partnerships must be regarded in the investigation as the permanent and prevalent industrial system of the country, and all arguments should recognize or be based upon this assumption. The present exceptional and experimental character of the system must be left out of sight as far as

possible, and favorable or unfavorable conditions due to this cause eliminated from the discussion.

What is the nature of wages? A capitalist and some laborers enter into an agreement for the purposes of production. Of the product, the capitalist is entitled to retain a certain share, and the laborers a certain share. Owing to the peculiar advantages which the possession of capital gives, the capitalist can wait till the product is sold before he claims his share; and, also, he can relieve the necessities of the laborers, who cannot wait, by paying them a certain fixed sum, at regular intervals, out of his capital, for which he expects to be reimbursed by the subsequent sale of the product. In consideration of this regular payment in advance, and the uncertainty which must always hang over the capitalist as to whether he shall be fully recouped at last, and also to indemnify him for his loss of interest, the laborers agree to take a smaller amount than they would otherwise be justly entitled to; *i.e.*, if they took their share on the same terms and uncertainties as the capitalist. In other words, wages are a *commutation* of the laborer's share of the product. The deduction from his theoretic share is a premium which he pays for the insurance of that share. But it is now demanded that the laborer shall receive not only his commuted fixed advanced share, but a fluctuating deferred share as well, if the product should happen to furnish the capitalist with an unusually large return. The capitalist is asked to give up some of that premium which makes it possible for him to pay a regular stipend to the laborers. The laborers are to be paid twice over,— are to receive their insured part of the product and be presented with the premium besides. The arrangement is an obviously unfair one.

This objection implies an uncertainty in the rate of profits; and here is an important consideration, which cannot be overlooked. The profits of nearly every form of business, under the stress of competition and the causes which produce fluctuations in the business world, are uncertain. The "average rate of profits," of which the economists speak, must not be taken too literally. The business man reckons his profits at so much per year, if he takes a series of years together; but

there will come times, with the best and most conservative business heads, when profits, owing to various causes which may be entirely beyond the control or the foresight of the individual, may quite disappear, or even give place to loss. Unforeseen rumors of war abroad, a season of cholera, unexpected action concerning tariff, by foreign governments or at home, a sudden disorder of the money market,— any one of a dozen causes may influence the result of a year's business for good or for bad, and that entirely without fault of the controlling head of the firm. But suppose that, in previous years, under a system of industrial partnership, the firm had divided all beyond a "fair" profit with their employees. They have now no resource such as they would have had if they had kept whatever profits they had made in good years for just such an occasion as this. Will the employees now turn about, and share losses with their employers? Assuredly not,— that is impossible. In a good year, then, capital may make what seems a large profit; but this will only make a fair average with bad years. Having shared the profits of prosperity, capital now has to bear the loss of adversity alone. To quote the words of a prominent American manufacturer, "We can give away profits, but would like to know how we can share losses."

Propositions have not been lacking for methods by which capital can "share losses" as well as "give away profits." The most feasible of such plans is the reserve fund system. In good years, a certain per cent. of profits is to be laid aside before paying bonus to labor, and put into a reserve fund which shall serve to support the establishment during the troublous times of a bad year or a commercial depression. In itself, the plan has justice to recommend it, and, if it could be consistently carried out, would probably meet the objection for which it is intended. The practical drawbacks to its introduction are, however, serious. The chief idea of industrial partnership is the direct stimulus of the prospect of immediate gain to the laborer. This stimulus is blunted by any prior claim on profits beyond the absolutely necessary one of immediate return of profit and interest on capital. The

same exertion will not be made, the same care and economy will not be exercised, to put money into a reserve fund, that would be exercised if the laborers knew that they were putting so much money into their own pockets. Hence, one chief cause of the efficiency of profit-sharing is in great degree lost.

Theoretically, the above objection concerning the inequality of profits in different years is of less weight than is generally given to it by practical men. The extra profits to be made by the increased efficiency and economy of labor, acting under the stimulus of immediate gain, is due, according to the theory of profit-sharing, to labor alone, and should be the property of labor alone. When the capitalist pays over this amount to labor, he is paying what really belongs to labor. He is not actually *sharing* anything, except under the conventional idea that all profits belong to capital.

In putting such ideas into practice, however, almost insuperable difficulties arise, sources of endless disagreement and dispute are opened. In actual business, it would prove extremely difficult to persuade the average business man that the profits which he saw standing in his books at the end of the year were not his own. They may have been gained by the increased efficiency of labor, but that is an almost imperceptible process. The business had gone on as usual. Orders had come in and been filled, the book-keepers had gradually filled up the books with figures relating to the details of the business, the laborers had all received their weekly wages, and gone about their work very much as usual. Is it likely that the average business man will see anything in all this to make him regard the profits he figures up at the end of the year as belonging in any part to his workmen? He has always been taught to regard them as his own, and he will continue so to regard them. And all this is on the supposition that he has been induced to believe in this scheme, as destined to regenerate the world of industry, and to give it a trial, and it is needless to say that this is a violent supposition to extend over all the various ramifications of business; for industrial partnerships must become the prevalent and

permanent organization of industry, according to our supposition. We can now see what a difficult supposition this is. The introduction of the system of profit-sharing has been the work of a few philanthropically inclined gentlemen, entirely from their own initiative. Its advantages, certainly, are not evident to most business men. And, however honorably those philanthropically inclined gentlemen have carried out their own agreements with their workmen, the morals of business are unfortunately such that it would be almost absurd to expect such action on the part of the entire business community. The only safeguard the interests of labor could have would be the publication entire of their employer's accounts, with the full record of profits or losses. And this is the source of another very serious objection to profit-sharing.

Secrecy in the matter of a firm's accounts is one of the most important elements in the security and stability of business, even in the soundest houses. If it were allowed to leak out whenever any temporary embarrassment arose, or if a firm published as its profits at the end of the year a much smaller amount than was recognized as necessary for the safe conduct of business, or, still worse, if it were obliged to publish the amount of its losses instead of its profits, there would at once be an end of all credit. And in credit is the mainspring of all business. What bank would keep up its discounts of the paper of a house that was confessedly losing money? Would such a house be able to make its purchases on time at favorable rates? A temporary embarrassment may arise in the safest and most conservative house, which can be tided over by means of its credit; but that credit would rapidly disappear if the condition of its affairs were published. This is one feature of profit-sharing that militates strongly against its general adoption.

Another objection to profit-sharing frequently put forward is based upon the same necessity of publishing the affairs of participating firms. It is that, if a house is making unusually large profits, and it becomes known, capital will immediately be attracted to that business, and competition will force down profits,— a thing which the firm could have avoided by keep-

ing secret the rate of its profits. But this objection relates to circumstances entirely incidental and exceptional. There are very few lines of business that make exceptional profits from lack of competition and as a permanent thing. These will inevitably be discovered, and the rush of capital will begin. Such circumstances can have little weight in the consideration of industrial partnerships, as applied to every-day business.

The Orléans Railway in France is one of the oldest cases of industrial partnership. For twenty years, it practised the system with considerable success, down to the years 1863–1870, when the profits going to labor fell off, and were reduced to a very low figure. This was due, partly to a change in the regulations, requiring a payment into a pension fund before distribution should be made to employés, but chiefly to the great extension of the railway by the absorption of other lines, and consequent great increase in the *personnel*, without a corresponding increase in the profits. In 1844, the number of participants was 719. In 1882, the number was 16,935. This experience illustrates one serious practical obstacle to the application of the principle of profit-sharing. This difficulty is liable to be felt not only in consequence of "stock-watering" in corporations,— sometimes a necessary and legitimate business operation,— but in private firms as well. Such a firm might wish to extend its operations, employing a large force of workmen to perform its increased business, and adding, possibly, to its capital. Now, in this case,— as very frequently happens in our large retail establishments,— the firm might be satisfied with a considerably smaller rate of profits, supposing that its increased facilities permitted it to turn over its capital more frequently every year. The increased force of workmen required to do this increased business, however, would not gain, but would suffer, supposing a system of profit-sharing to be in force. Though the gross profits of the firm might be enough to satisfy it, even though they were a smaller percentage of the capital,— for the total income might remain the same or even be increased,— yet the amount going to each workman would be reduced or entirely swept away. Industrial partnerships would thus be made impossible in a large class of

establishments, or at least would be greatly impaired in their efficiency.

The *entrepreneur* is perhaps the most important man in the modern industrial system. The greatest rewards in the field of business are paid to him who can best carry on the great business enterprises of the world. The managing ability is a very rare one in its highest development, and its reward is proportionately great. But there is as much difference in the quality of those who undertake the functions of the *entrepreneur* as in any other branch of human activity:—

> The successful conduct of business under free and active competition is due to exceptional abilities or to exceptional opportunities. . . . First, we have those really gifted persons who, in common phrase, seem to turn everything they touch into gold. . . . Next, . . . the much larger class of men of a high order of talent, . . . sagacious, prompt, and resolute. . . . Then the men . . . well-to-do or pretty well-to-do, . . . men who are never masters of their fortunes, . . . yet who win no small profits. . . . Lower down . . . are a multitude of men who are found in the control of business enterprises for no very good reason that can be seen, . . . sometimes doing well, but more often ill. . . . More commonly, they have forced themselves into business under a mistaken idea of their abilities.*

Such being the difference observable between different members of the managing class, what would be the result, under a widely spread adoption of industrial partnerships? It would be simply to subordinate the pay of the laborer to the success of the capitalist who employs him. Let us suppose two factories, run by two *entrepreneurs* of different degrees of business ability,—one a highly successful "captain of industry," the other, one of the lower grades of men. Industrial partnership is adopted in both mills. The two sets of laborers work equally hard under the stimulus of the expected addition to their stipulated wages. They are equally economical, and, on the whole, equally skilful and efficient. At the end of the year, it is found that one mill has made large profits; the other, scarcely enough to pay interest on the capital invested. The one pays its stockholders a handsome dividend, and has enough to divide ten or fifteen per cent. of

* F. A. Walker, *Political Economy*, pp. 248–251.

wages as a bonus among its operatives, besides the current rate of wages. The other set of laborers receive nothing beyond their wages. This disparity has arisen, not from any fault of the second set of operatives, not through any deficiency in productive capacity of the second mill, but solely through the poor management of the business in the counting-room. It is neither equitable nor reasonable that such results should appear; yet they must inevitably and constantly appear, under an extended system of industrial partnerships. It is needless to say that it is simply impossible that any industrial system should long be carried on under such inequitable conditions. It is an imperative demand of economic law that, where competition and the movement of labor are free, similar services shall receive the same reward. As the rate of wages in one cotton mill cannot permanently vary from the rate in another, still less can the rate of reward for equal services vary — as it would inevitably vary under a system of industrial partnership — between two such mills as we have supposed, which might be on opposite corners of the same street.

We may venture, however, to draw one general principle, which, if established, will prove of great practical service in the application of industrial partnership, when some means have been found of escaping the difficulties suggested. A study of the actual cases of its trial will show that, where capital plays a subordinate part, where the functions of the *entrepreneur* are reduced to the minimum, where wages of superintendence to secure the best results are necessarily high under the ordinary conduct of the business, there will industrial partnership be applied with the best chance of success. Take, for example, the celebrated Maison Leclaire, the Parisian house-painting establishment, where profit-sharing was first introduced. The business of house-painting is one in which capital holds a subordinate part. Labor is the chief factor. On skill, industry, care, and economy, and a high standard of work done, rest the reputation and the success of the house. These things industrial partnership is likely to secure. Superintendence is difficult and expensive where workmen are scattered, perhaps, over a whole city. Such a business does not require for its success the great faculties

of business management, the rare qualities of an *entrepreneur*. Let it be for the interest of the workmen that they exercise skill, care, economy, and industry, and they become their own superintendents. The money that would otherwise be paid for this can with justice and profit be paid to them.

Similar is the case of the Orléans Railway. Material used, fuel, and the wear and tear of the rolling-stock and other costly equipment constitute a great part of the expense of running, when once the road has been built. Superintendence here, too, is difficult, and expensive in the extreme. In fact, every employee of a railway must necessarily have a certain responsibility, not only over materials, but also over human life,—from a business point of view, far more costly than materials,—utterly unknown to the ordinary workman. To secure the best meeting of this responsibility, industrial partnership may prove, in a limited measure, effective.

Agriculture is another example of the same sort. Manual labor is the chief part. Capital is in the background. The functions of the *entrepreneur* almost disappear, and increase of efficiency of labor makes an important element of success.

With industrial partnerships in manufactures, however, the case is far different. Most of the objections are here applicable in full force. Financial management is a preponderating part of the business. Much labor-saving machinery is used, requiring little operative skill; and such skill and industry as are necessary may be easily secured, from the fact that all employees are together in one building, and superintendence is easy and effective. Success depends chiefly upon the controlling head in the treasurer's office.

But, granting all that is claimed for the system of industrial partnership by its advocates, suppose it introduced and in operation in all the various departments of industry where labor is hired. In what respect will the situation of labor and capital be changed? What present difficulties are settled? Will there be any less difficulty between employers and employed concerning the rates of wages, independent of the question of bonus? There will be exactly as much as at present to quarrel over in fixing that rate. The most that will result will be a slight change in the respective levels

of return to capital and labor, and the permanence of this change may well be doubted. All labor would receive a greater or less additional return under the name of "profits" or "bonus"; but when these "profits" become the rule, and not the exception, will the prospect of receiving them afford the same stimulus that it does now? It is even a question whether the action of competition would not force down the rate of wages, strictly so called, until the total remuneration is no greater than at present.

As for the solution of the "labor problem," which is confidently asserted to have been discovered in industrial partnership, it is a delusive hope. Profit-sharing firms please and satisfy their employees by the "profits" or "bonus" which they pay them beyond their usual wages, such as their less favored fellow-workmen receive, and then announce that they have found an end for strikes and all difficulties with labor. Is it not possible that much of this satisfactory result is due to the exceptional character of the system at present, and the exceptional position of operatives, instead of to any essential virtue of the system which will continue after it has become universal? The glamour and emotional interest which surround the experiments in industrial partnership have prevented any practical test from ever yet being made, that would give the system an undoubted claim to be considered a solution of the "labor problem." There are practical considerations, as we have seen, which will probably render any such test impossible. But it would also seem that there are theoretical reasons for doubting the justice, the reasonableness, and the efficiency of the scheme as a possible rearrangement of the industrial system.

RICHARD ALDRICH.